INTERNAL REVENUE SERVICE NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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> Taxpayer's Name: Taxpayer's Address:

Taxpayer's Identification Number:

Years Involved:

Date of Conference:

I FGFND:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

Subsidiary:

ISSUE:

Whether Taxpayer, a motion picture production and distribution company, may calculate depreciation for a motion picture film using a variation on the income forecast method under which Taxpayer does not reduce current year income or estimated total income (the numerator and denominator of the income forecast fraction) by the cost of distributing the film.

CONCLUSIONS:

- (1) Taxpayer's depreciation method is not a permissible application of the income forecast method described in Rev. Rul. 60-358 (1960-2 C.B. 68).
- (2) Taxpayer's method is not permissible under section 167 of the Internal Revenue Code as a method separate and distinct from the income forecast method.
- (3) For film property (including any partial interest in a film) placed in service during the years at issue for which Taxpayer computed a depreciation deduction under the "gross method", Taxpayer must recompute the deduction using the income forecast

method as described in Rev. Rul. 60-358, including the requirement that current year income and estimated total income be reduced by the cost of distributing the film. FACTS:

Taxpayer, through a variety of subsidiaries, operates businesses in several media areas including broadcasting (television, cable, and satellite), publishing (book, magazine, and newspaper), and the production, marketing, and distribution of motion picture films and television shows. Taxpayer owned (directly or indirectly) 100 percent of Subsidiary, a United States corporation, during the years at issue. Subsidiary is primarily engaged in the financing, development, production, distribution, and marketing of motion pictures, and of television and home entertainment programming throughout the world. Subsidiary distributed films during the period at issue in which Subsidiary had full or partial ownership interest, as well as films in which Subsidiary had no ownership interest.

Taxpayer depreciates the cost of producing or acquiring motion pictures, including both wholly-owned self-distributed films and self-distributed films in which it owns only a partial or limited interest, using a variation on the income forecast method. Under Taxpayer's method, which it designates the gross income forecast method (hereinafter, the "gross method"), Taxpayer uses the ratio of current year income from the property (undiminished by distribution cost) to forecasted total income from the property (undiminished by distribution cost) to determine the current allowance for depreciation.

Taxpayer's use of this "gross method" was challenged on examination, resulting in this request for technical advice. Taxpayer represents that its use of the "gross method" is necessary because Taxpayer's accounting system does not separately track all distribution expenditures for an individual motion picture, and therefore Taxpayer cannot use the standard income forecast method. Taxpayer declined to make its records of these costs available for examination or for this technical advice request. Instead, an agreement was reached between Taxpayer and the exam team that the technical advice request would be submitted on the basis of a generalized fact pattern believed to be representative.

On Date 1, a conference of right was held in the National Office with representatives of both Taxpayer and the IRS in attendance. Taxpayer submitted follow-up comments and arguments on Date 2. Subsequently, in response to a FOIA request, the National Office supplied Taxpayer with background files from Rev. Rul 60-358, Rev. Rul. 64-273 (1964-2 C.B. 62), Rev. Rul. 79-285 (1979-2 C.B. 91), and GCM 37800 (December 27, 1978). After reviewing those files, Taxpayer submitted additional comments and arguments in a letter dated Date 3.

On Date 4, the National Office requested additional facts that it considered relevant to resolving the issues presented in this technical advice memorandum. These

facts were requested in order to enable this advice to be drafted on the basis of actual facts, rather than the general "situation" posited in the technical advice request. In a letter dated Date 5, one of Taxpayer's representatives notified the National Office that Taxpayer considered the information request "unduly burdensome", and the requested information was not supplied.

LAW AND ANALYSIS:

Section 168 of the Code provides rules for depreciating property under the modified accelerated cost recovery system, or MACRS. However, section 168(f)(3) specifically precludes taxpayers from depreciating motion picture films and videotapes using MACRS. Consequently, the capital costs associated with producing or acquiring a motion picture must be recovered under section 167.

The issue of whether Taxpayer's present method is permissible is best considered in three parts. First, is Taxpayer's method a permissible application of the income forecast method authorized in Rev. Rul 60-358? Second, if Taxpayer's method is not a permissible application of the income forecast method, does it constitute a separate permissible method under section 167 of the Code? Third, if Taxpayer is not properly using the income forecast method and is not using a different permissible method, how must Taxpayer calculate its depreciation deductions for film properties placed in service in the years at issue?

Issue #1: Is Taxpayer's method a valid application of the income forecast method?

The income forecast method was established as an allowable method for television shows in Rev. Rul 60-358, and its use was extended to motion pictures in Rev. Rul. 64-273¹. Rev. Rul. 60-358 recognized that time-based methods of depreciation formerly described in section 167(b) of the Code are in most cases inadequate when applied to television films and other property of a similar nature because of the unique income-producing characteristics of such properties due to variables such as audience appeal. Use of a time-based method can distort income due to the uneven flow of income that typically results from such properties. The income forecast method mitigates this distortion by permitting taxpayers to recover the depreciable basis in appropriate property over the income anticipated to be earned from the property during its useful life. The income forecast formula uses the ratio of current year income from the property to forecasted total income from the property, multiplied

¹ Section 167(g) of the Code, which codified the applicability of the income forecast method to films and other similar properties and expanded the rules and requirements for applying the method, is not applicable to the years at issue in this technical advice request.

by the adjusted basis in the property, to determine the allowance for depreciation for a given year.

Rev. Rul. 60-358 specifically states that the term "income" for purposes of this ratio "means income from the films less the expense of distributing the films, not including depreciation." A failure to reduce income by the distribution expense generally results in an acceleration of depreciation deductions, as most distribution expenses are paid or incurred in or before the year the film is released for exhibition.

In the typical case of a taxpayer that owns an interest in a film but does not itself distribute the film, the distributor receives from exhibitors a share of the proceeds from the exhibition of the film. The distributor reduces those proceeds by the amount of its incurred distribution costs (typically, advertizing and print costs) and a distribution fee before paying the remainder to the film owner. This net amount is the film owner's gross income from the property.

However, if a film owner distributes the film itself (a "self-distributor") instead of contracting with a third-party distributor, the gross income received by the owner from the exhibitor of the film has not been reduced by the cost of distributing the film. The self-distributed taxpayer deducts these distribution costs in the year paid or incurred (generally, in or before the year that the corresponding income from the film is recognized).

An extensive line of cases and rulings affirms that if a film is distributed by a third party and the distributor reduces its proceeds by the amount of its incurred distribution costs and a distribution fee before paying the remainder to the film owner, the current year income figure to be used in computing the ratio for income forecast purposes cannot exceed the film owner's gross income from the film. See, Rev. Rul. 78-28, 1978-1 C.B. 61; Gordon v. Commissioner, 766 F2d 293 (7th Cir. 1985); Siegel v. Commissioner, 78 T.C. 659 (1982); and Wildman v. Commissioner, 78 T.C. 943 (1982); all of which denied taxpayers any deduction for depreciation for a taxable year in which they received no gross income from the film. See, also, Schwartz v. Commissioner, 47 T.C.M. 937 (1984) (cash method taxpayer could not include in income forecast calculation amounts due from distributor but not yet received); Shied v. Commissioner, 50 T.C.M. 663 (1985) (accrual method taxpayer permitted to include in income forecast calculation amounts due from distributor but not yet received because such amounts were required to be included in gross income).

Taxpayer urges us to view these cases as support for its use of the "gross method" because Taxpayer uses its gross income from the film to compute its deductions. However, Taxpayer's assertion ignores the fact that none of the cases cited by Taxpayer involve an owner who distributes its own films, and that none of the cases address whether a film owner who receives proceeds undiminished by

distribution expense is entitled to use its gross income to compute a deduction under the income forecast method without first reducing the income by the cost of distribution.

The closest the courts have come to addressing this specific question is in Greene v. Commissioner, 81 T.C. 132 (1983). Greene involved an arrangement between a film owner ("Alpha") and a distributor under which proceeds from the exploitation of the film were to be deposited by the distributor in a joint account that could be only be accessed only over the joint signatures of both parties. The arrangement provided that the proceeds were to be withdrawn and distributed first to the distributor to recoup its actual distribution expenses, then to the distributor for a distribution fee based upon a percentage of gross proceeds, then last to Alpha. The gross proceeds of the film were insufficient to cover even the cost of distribution, and no gross proceeds from the film were distributed from the account to Alpha. For the years at issue, however, Alpha reported the total amount deposited in the account as gross income and claimed depreciation deductions under the income forecast method based on those gross income amounts.

The Tax Court in <u>Greene</u> granted summary judgement to the Commissioner, stating that

"because Alpha elected to use the income forecast method, it was required to use that method as prescribed by the Commissioner in the absence of requesting and securing his approval to change its method. Moreover, ... its method was clearly improper. Thus, we hold that, as a matter of law, Alpha was required to use net income in the numerator of the income forecast fraction. There is a question as to whether the gross receipts deposited in the special account constituted gross income received by Alpha, but in view of our conclusion that only net income was to be used in the numerator of the income forecast fraction, and in view of the fact that Alpha had no net income in 1975, we need not decide whether the gross receipts constituted gross income of Alpha. Consequently, ... Alpha was entitled to no depreciation deduction for 1975".

Thus, the <u>Greene</u> court found it to be immaterial for income forecast purposes whether taxpayer had gross income from the film; what matters is whether the taxpayer had income from the film after distribution costs had been subtracted from the proceeds. We believe that the court's opinion in <u>Greene</u> correctly states the application of Rev. Rul. 60-358. Application of the court's reasoning to the facts presented to us in this request for technical advice compels the conclusion that Taxpayer apply the income forecast method using income net of distribution costs without regard to whether Taxpayer has reportable gross income from the film.

Taxpayer asserts that its use of the "gross method" is supported by language in G.C.M. 37800 stating that the drafters of Rev. Rul. 60-358 intended that gross income figures be used in determining deductions under the income forecast method.

General Counsel Memoranda were used as internal Service communications in the process of developing public guidance, and represent only the opinion of the individuals that drafted and reviewed the memoranda. Frequently, they represented a contrasting point of view to the position taken in proposed guidance; the parties would then endeavor to resolve the differences in opinion prior to finalizing the guidance. Although they were once released to the public, General Counsel Memoranda were purely internal documents at the time GCM 37800 was written. GCMs from this period did not become available for public inspection until December 24, 1981, and do not represent public statements of Service position past or present. In any event, we are not persuaded that GCM 37800 correctly states the law or its intent with respect to the income forecast method.

The GCM, written prior to the <u>Greene</u> decision in response to an internally-circulated pre-publication draft of Rev. Rul. 79-285, 1979-2 C.B. 91, concerns a taxpayer who purchases all rights to a book manuscript and contracts with a third party to publish and distribute the book. Under the contract, the publisher/distributor recoups its costs and a distribution fee from the gross proceeds of sales, and pays any net amount to the taxpayer. The issue examined in the GCM is whether a taxpayer may amortize the cost of the purchased manuscript using a sliding scale method. The GCM reaches conclusions regarding whether the property was placed in service in the year at issue and, if so, whether the amortization period during the year is correctly determined. Rev. Rul. 79-285 reaches substantially the same conclusions. The GCM also concludes that the sliding scale method may be appropriate in situations where it can be demonstrated to clearly reflect income. This conclusion, however, was not adopted in Rev. Rul. 79-285.

The GCM then discusses whether the income forecast method should be the exclusive method (other than the straight-line method) available for depreciating films, book manuscripts, and similar properties. The GCM notes that, under the terms of Rev. Rul. 60-358, a property that does not generate sufficient proceeds in a given year to cover the distribution costs applied against those proceeds in that year by the distributor will result in no proceeds being paid to the owner of the property, and thus no depreciation deduction for the owner, for that year. The drafter of the GCM seems to have viewed this as an inequitable result, and the GCM concludes that this result does not clearly reflect income because depreciation deductions and the gain or loss from the property are not spread over the entire period that the property is producing

income². The GCM concludes that in such cases interpreting the income forecast method to allow a "gross method" approach may produce a clearer reflection of income than the standard income forecast method and should therefore be a permitted. This conclusion, however, is mere commentary, given that it is inapplicable to the taxpayer at issue in the GCM and the underlying revenue ruling because that taxpayer's gross income was already reduced before receipt by distribution costs³. Further, the GCM provides no indication that the income flow from the publication of the manuscript was such that the standard income forecast method would have produced anything other than a clear reflection of income. This portion of GCM 37800 was not incorporated into Rev. Rul. 79-285 or otherwise adopted as the Service's position on the issue, and subsequent cases have rejected this concern, denying deductions under the income forecast method for taxable years in which the gross proceeds from the film do not exceed the cost of distributing the film. See Gordon, Siegel, Wildman, and Greene, infra.

The GCM also makes an unsupported and unexplained statement that the authors of Rev. Rul. 60-358 "intended that gross income figures be used", then states that, because the revenue ruling "is focused on an owner of the motion picture rights who employs an outside distributor", the requirement that income be reduced by distribution cost was necessary in order to calculate the owners gross income. Taxpayer cites this as direct support for its use of the "gross method". However, the

² By the time a return is filed for the taxable year in which a particular film is released, the owner of the film knows the current receipts and the allocable distribution cost for that year and has a fairly accurate idea what the cost of distribution and the overall return from the film will likely be (if this were not the case, the use of the income forecast method would not be possible). If the film's receipts do not exceed distribution costs for that first year, and analysis of future costs and receipts indicates that the use of the income forecast method would yield an unsatisfactory result, the taxpayer has the alternative of using the straight line method for that film.

GCM 37800 discusses this concern because it was written during the effective period (January 1, 1976, through December 31, 1986) of former section 280 of the Code, which required the use of the income forecast method by individuals (and certain entities treated as individuals) for certain costs attributable to the production of motion picture films and similar properties. Given that section 280 no longer operates to deny the use of the straight line method for these costs, it is unlikely that a sophisticated taxpayer would find itself in the position described in the GCM (unable to take a first year depreciation deduction) unless it chooses to do so due to other tax planning considerations.

³ In fact, the taxpayer at issue in GCM 37800 would be barred under case law from using any amount in excess of its own gross income in calculating its deductions.

case file underlying Rev. Rul. 60-358 shows that no particular taxpayer or fact situation formed the basis of the revenue ruling. To the contrary, the revenue ruling was meant to provide for the entire television industry an alternative to the abolished "cost recovery" method. Nothing in the case file contradicts the plain language of the revenue ruling that income for purpose of the ratio means income from the films less the expense of distributing the films. Taxpayer requested and has been provided with a copy of the Rev. Rul. 60-358 case file⁴.

This portion of GCM 37800 was not incorporated into Rev. Rul. 79-285 or otherwise adopted as the Service's position on the issue, as shown by the arguments successfully advanced by the Service in the subsequent <u>Greene</u> case. Consequently, the Service's published position for the years at issue in this case is that the proper application of income forecast method is described in Rev. Rul. 60-358, and includes <u>for all taxpayers</u> the requirement that, for purposes of the computation ratio, income means income from the films less the expense of distributing the films⁵.

We conclude that Taxpayer, in the words of the Tax Court, "chose a clearly acceptable method (income forecast) but simply used such method improperly." <u>See Wildman</u>, 78 T.C. at 952. Taxpayer's "gross method" is not a permissible application of the income forecast method authorized in Rev. Rul. 60-358.

Issue #2: Is Taxpayer's method a "reasonable method" permissible under section 167?

⁴ After reviewing this case file and the case files for Rev. Rul. 64-273, Rev. Rul. 79-285, and GCM 37800, representatives for Taxpayer stated in the letter dated Date 3 that the case files do not specifically indicate the reason Rev. Rul 60-358 requires income to be reduced by distribution costs or why such an approach produces a clear reflection of income, and argued that, as a result, the imposition of such a standard currently without a showing why this standard clearly reflects income would be "arbitrary, capricious, and without sound basis in fact or law." We do not believe that the mere passage of time causes the application by the Service of a published position that has stood for over 40 years, and that has been accepted as producing a clear reflection of income by the courts and by the United States Congress, to be either arbitrary or capricious, and we feel that the analysis in this technical advice memorandum demonstrates that the application of the income forecast method as described in Rev. Rul. 60-358 has a thoroughly supportable basis in fact and law.

⁵ We note that Congress, in the legislative history to section 1604 of the Small Business Act, which became section 167(g) of the Code, restates with approval the rule requiring income to be reduced by distribution expense in its discussion of existing law. <u>See</u> Joint Committee on Taxation, <u>General Explanation of Tax Legislation Enacted</u> in the 104th Congress (Comm. Print 1986) at 218.

Taxpayer has argued that, if Taxpayer's method is not a permissible application of the income forecast method, the Service should nonetheless treat Taxpayer's "gross method" as a formal method, separate and distinct from the income forecast method, that is a permissible method under section 167 of the Code.

Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes its income in keeping its books.

Section 446(b) of the Code provides that if the taxpayer does not use a regular method of accounting, or if the method used by the taxpayer does not clearly reflect income, taxable income will be computed in accordance with a method that, in the opinion of the Secretary, does clearly reflect income.

Section 167(a) of the Code provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or held for the production of income.

Section 1.167(b)-0(a) of the income tax regulations provides that any reasonable and consistently applied method of computing depreciation may be used under section 167 of the Code. Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made. It is the responsibility of the taxpayer to establish the reasonableness of the deduction for depreciation claimed. Generally, depreciation deductions so claimed will be changed only where there is a clear and convincing basis for a change.

Section 1.167(b)-1(a) of the regulations provides that the straight line method may be used in determining a reasonable allowance for depreciation for any property that is subject to depreciation under section 167 of the Code and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

Taxpayer argues that once it has established a method of accounting, the Commissioner cannot compel it to use a different method unless the Commissioner shows that the taxpayer's method fails to clearly reflect income. However, as discussed in our analysis of Issue #1, we do not believe that Taxpayer has established a method of accounting separate and distinct from the income forecast method described in Rev. Rul. 60-358, but has simply misapplied the income forecast method. Therefore, in denying Taxpayer the ability to compute its deductions under the "gross method" we are

not changing deductions claimed under a "reasonable and consistently applied method", but instead are correcting deductions claimed under a misapplied method.

If, in the alternative, Taxpayer's gross income forecast method were found to be a method separate and distinct from the income forecast method, we believe that it still would not be a permissible method under section 167 of the Code.

As described in the enumerated facts, Subsidiary distributes films in which it holds an ownership interest and films owned by unrelated taxpayers. This means that its distribution operation is conducted with an independent profit motive, rather than simply as a vehicle for realizing income from Taxpayer's own films. As such, for purposes of applying the income forecast method, Taxpayer's distribution operations should be considered a separate and distinct business operation from its film production and acquisition operations. Under this analysis, it would be improper to allow Taxpayer to utilize the tax-deductible expenses of its distribution operations to accelerate capital recovery in its production and acquisition operations.

Rev. Rul. 60-358 states that the usefulness of a film in a taxpayer's trade or business is measurable over the income it produces. Taxpayer argues that the "usefulness" of a film in Taxpayer's trade or business is measured by Taxpayer's gross income earned through exploiting the film, unreduced by the cost of distributing the film, because Taxpayer looks to that income both for profit and for reimbursement for those distribution costs, and that its method is therefore reasonable under the rationale of Rev. Rul. 60-358. However, the portion of Taxpayer's gross income that is "useful" because it recoups distribution costs is directly matched by an expense deduction for those costs. Only the portion of Taxpayer's gross income that represents the recovery of the capital cost of producing or acquiring the film (the portion that is not already offset by an expense deduction) is "useful" in the sense that Rev. Rul. 60-358 contemplates, and so only that portion should be used as the measure of "income" for purposes of calculating a depreciation deduction.

In addition, because most distribution costs are paid or incurred in advance of the receipt of the allocable income from the property, permitting Taxpayer to use its "gross method" would generally result in an acceleration of Taxpayer's deductions over the deduction obtainable by a taxpayer using the income forecast method as described in Rev. Rul. 60-358⁶. This improper acceleration of deductions provides exactly the type of distortion of income that the <u>Greene</u> court rejects when it states that

Moreover, the use of the income forecast method as prescribed by the Commissioner has the advantage of assuring similarity of treatment for owners of films. If the owner uses a standard distribution agreement, his depreciation deduction is based on the net income received by him. An owner may distribute his own film or may employ an agent, and in such case he will be treated in a like manner if he is required to compute his depreciation on the basis of his net income." Id at 139.

Taxpayer argues that its method is consistent with the "individual-film-forecast-computation" method under GAAP and with industry practice. While these factors are relevant to the overall balance of factors in determining whether a method of accounting is permissible, we do not find either to be dispositive in this case. Furthermore, Taxpayer has submitted no evidence to prove that its method is consistent with the "individual-film-forecast-computation" method under GAAP and with industry practice.

Finally, we note that although Taxpayer urges that we conclude that they have adopted a method that clearly reflects income, they have refused to provide actual figures with which to evaluate that conclusion. Instead, Taxpayer has argued that we should reach our conclusion on the basis of hypothetical situations prepared by Taxpayer. However, technical advice memoranda are designed to address the actual facts reflected in a taxpayer's tax return. Taxpayer was provided an opportunity to prove the contention that the "gross method" clearly reflects income by submitting detailed information from its transactions during the years at issue, but declined to do so. Taxpayer maintains that its accounting system does not capture its cost of distributing a film, and that it therefore cannot accurately calculate its deductions under the income forecast method; however, we cannot conclude that Taxpayer's method clearly reflects income without first evaluating its method in light of actual gross revenues and distribution costs from Taxpayer's films. We only have Taxpayer's assertion that its method clearly reflects income or provides a reasonable allowance for depreciation. Consequently, Taxpayer has failed to met the burden imposed by section 1.167(b)-0(a) of the regulations requiring Taxpayer to establish the reasonableness of the deduction for depreciation claimed.

⁶ This acceleration is because the majority of distribution expenses are typically being paid or incurred in or before the year that the film is placed in service. Taxpayer has provided a hypothetical example in which Taxpayer's method produces a slower amortization than that produced using a proper application of the income forecast method; however, this hypothetical is premised on the distributor spending a ratably larger amount on distribution costs in later years than in the initial year. It is our understanding that this would seldom, if ever, occur in practice.

If a taxpayer is shown to be using an improper method, the Commissioner may change the taxpayer's method without regard to whether the method arguably reflects income clearly. Consequently, we conclude that even if Taxpayer's method is a method separate and distinct from the income forecast method, Taxpayer's "gross method" is not a reasonable method permissible under section 167 of the Code.

Issue #3: What method must Taxpayer use for film properties placed in service in the years at issue?

Section 446(e) provides that a taxpayer may not change to a different method of accounting without first securing the permission of the Commissioner. Several cases have applied this principle to taxpayers that originally elected the use of the income forecast method. <u>See</u>, e.g., <u>Wildman</u>, supra; <u>Bizub v. Commissioner</u>, 46 T.C.M. 199 (1983); <u>Tarricone v. Commissioner</u>, 47 T.C.M. 277 (1983).

In addition, several cases have permitted the Service to require a taxpayer to switch from an impermissible method to the income forecast method. <u>See</u>, e.g., <u>Schneider</u>, supra; <u>Schwartz v. Commissioner</u>, T.C. Memo 1987-381, 54 T.C.M. 11 (1987); <u>Garner v. Commissioner</u>, 54 T.C.M. 824 (1987); <u>Green v. Commissioner</u>, 57 T.C.M. 1333 (1989). In <u>Law v. Commissioner</u>, 86 T.C. 1065 (1986), the Tax Court agreed that the taxpayer's declining balance method was inappropriate, but permitted the taxpayer to choose between the income forecast method and the straight line method.

As stated in the discussion of Issue #1, infra, Taxpayer chose to apply the income forecast method to each of the films at issue, but misapplied that method resulting in an impermissible method and an unreasonable allowance for depreciation. Taxpayer's argument that its "gross method" should be viewed as a separate "reasonable" method under section 167 of the Code is rejected, as discussed under Issue #2, infra. Consequently, Taxpayer must continue the use of the income forecast method, but Taxpayer must properly apply that method.

Therefore, for film property (including any partial interest in a film) placed in service during the years at issue for which Taxpayer has computed a depreciation deduction under the "gross method", Taxpayer must recompute all depreciation deductions for that property using the income forecast method as described in Rev. Rul. 60-358. In calculating current year income and estimated total income for purposes of the income ratio, Taxpayer's gross income from the film must be reduced by the cost of distributing the film, including, but not limited to, print and advertising costs relating to the film and an allocable share of the administrative and overhead costs of Taxpayer's distribution operation. To the extent that Taxpayer is unable to provide records sufficient to calculate distribution costs for a film, a reasonable estimate should be made; participation statements issued to parties involved in the production of

the film, charges for the allocable portion of distribution costs to any co-owners of the film, etc., can be used for this purpose.

Temporary or final regulations pertaining to one or more of the issues addressed in this memorandum have not yet been adopted. Therefore, this memorandum will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the memorandum. See section 18.04 of Rev. Proc. 2002-2, 2002-1 I.R.B. 82, 110 (or any successor). However, a technical advice memorandum that modifies or revokes a letter ruling or another technical advice memorandum generally is not applied retroactively if the taxpayer can demonstrate that the criteria in section 18.06 of Rev. Proc. 2002-2, are satisfied.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.